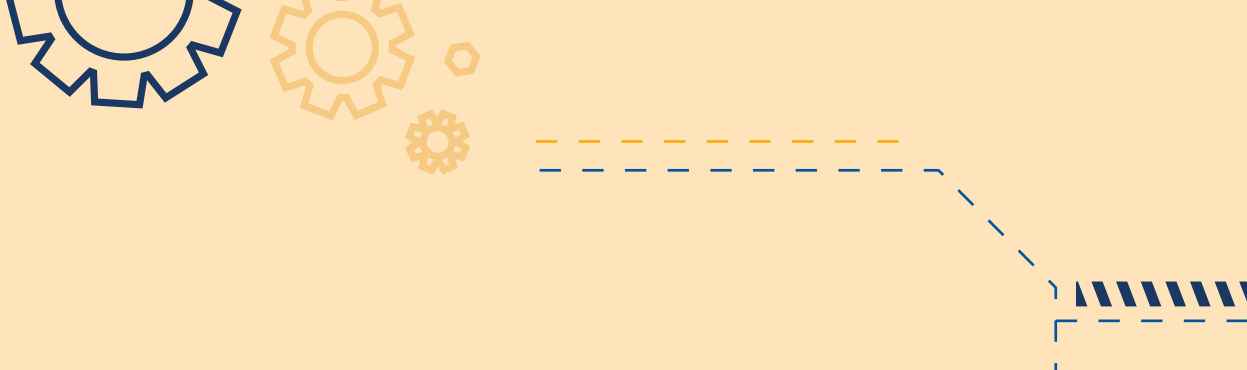




GUIDANCE NOTE

ON STRENGTHENING OPERATIONAL DISCIPLINE IN MICROFINANCE





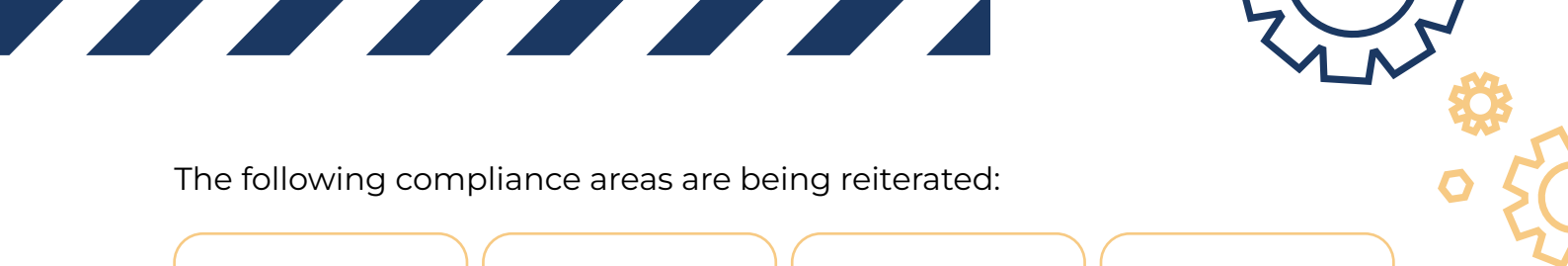
GUIDANCE NOTE ON SELECT KEY OPERATIONAL AREAS IN MICROFINANCE

Microfinance plays a critical role in advancing financial inclusion by enabling low-income households to access formal credit and essential financial services. As the sector continues to evolve, ensuring robust operational practices has become essential to protect customer interests, sustain institutional viability and uphold regulatory expectations. Recent supervisory observations, third-party assessments and field-level interactions have revealed certain operational gaps and inconsistencies across most institutions, underscoring the need for stricter implementation and uniformity in practices.

This Guidance Note has been developed to reiterate certain existing instructions under the RBI's regulatory framework and the industry code of conduct, with the objective of ensuring consistent and uniform implementation across institutions.

It aims to support regulated entities in strengthening internal processes, enhancing governance and compliance, and promoting responsible lending practices.

THE OBJECTIVE OF THIS NOTE IS TO FOSTER GREATER STANDARDISATION, TRANSPARENCY, AND CUSTOMER-CENTRICITY IN MICROFINANCE OPERATIONS, WHILE ENSURING ADHERENCE TO APPLICABLE REGULATORY AND INDUSTRY STANDARDS.



The following compliance areas are being reiterated:

Household
Income
Assessment –
Recording
reasons for
Income
Divergence as
per RBI
regulations

Key Facts
Statement
(KFS) –
Implementation
as per RBI
regulations

Pricing of
Microfinance
Loans – To
cover all the
components as
per RBI
regulations

Non - Bundling
of Third-party
Products
(TPPs) with the
primary credit
product as per
MFIN Directive
and Guardrails

The applicable regulatory standards, key observations emerging from SRO reviews, and the corresponding actions required to be undertaken by members in respect of the above-mentioned areas are detailed below:-



HOUSEHOLD INCOME ASSESSMENT – RECORDING REASONS FOR INCOME DIVERGENCE AS PER RBI REGULATIONS

REGULATORY STANDARD

As per the RBI's Regulatory Framework for Microfinance, "reasons for any divergence between the already reported household income and the assessed household income shall be specifically ascertained from the borrower before updating the assessed household income with the CICs."

OBSERVATIONS BY THE SRO

It has been observed that the majority of REs do not currently maintain a record of such reasons in their systems. This gap may lead to non-compliance with the regulatory requirement.

ACTION REQUIRED

This information should be explicitly captured, documented, and stored as part of the underwriting process, and maintained separately for regulatory compliance purposes. Systematically recording the reason for any deviation from an earlier assessed income not only supports adherence to RBI requirements and enables full traceability during audits or supervisory reviews but also strengthens and brings greater rigour to the income assessment process.



KEY FACTS STATEMENT (KFS) – IMPLEMENTATION AS PER RBI REGULATIONS

REGULATORY STANDARD

The RBI circular on the Key Facts Statement (KFS) for Loans & Advances issued on 15th Apr 2024 clearly outlines the operational requirements that the REs must follow while providing KFS to the customers. The same is also included in the microfinance regulations.

The clauses are detailed in the Annexure.

OBSERVATIONS BY THE SRO

It has been observed that although all REs have initiated the process of issuing the KFS, in some instances the practice does not align with regulatory standards specifically in terms of having a unique number, validity period, inclusion of APR etc.

ACTION REQUIRED

REs should standardize their KFS issuance process in full alignment with RBI guidelines, ensuring that the KFS is provided separately with its validity as per the mandated timelines. Regular staff training and internal compliance checks should be instituted to prevent deviations and ensure consistent implementation across all branches.



PRICING OF MICROFINANCE LOANS – TO COVER ALL THE COMPONENTS AS PER RBI REGULATIONS

REGULATORY STANDARD

As per the RBI's Regulatory Framework for Microfinance Loans, each RE shall put in place a board-approved policy regarding pricing of microfinance loans which shall, inter alia, cover the following:

- ◆ A well-documented interest rate model/ approach for arriving at the all-inclusive interest rate.
- ◆ Delineation of the components of the interest rate such as cost of funds, risk premium and margin, etc. in terms of the quantum of each component based on objective parameters.
- ◆ The range of spread of each component for a given category of borrowers.
- ◆ A ceiling on the interest rate and all other charges applicable to the microfinance loans.

OBSERVATIONS BY THE SRO

It has been observed that some REs have not clearly incorporated these requirements while arriving at the all-inclusive interest rate. Specifically, the range of spread of each component was not found to be mentioned in few cases.

ACTION REQUIRED

REs should strictly adhere to the RBI's pricing policy for microfinance loans and ensure that all four prescribed components are clearly captured and explained in their respective internal policies.



NON - BUNDLING OF THIRD-PARTY PRODUCTS (TPPs) WITH THE PRIMARY CREDIT PRODUCT AS PER MFIN DIRECTIVE AND GUARDRAILS

INDUSTRY STANDARD*

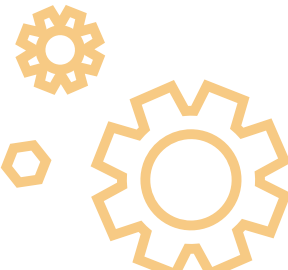
MFIN Directive #5 on Third Party Products states that there should be a minimum time gap of one month between the disbursement of the primary credit product and the credit for financing the third-party product or vice versa. The same was reiterated in the MFIN Guardrails as well.

OBSERVATIONS BY THE SRO

While the MFIN directive and the Guardrails clearly specify that there must be a minimum gap of one month between the disbursement of the primary credit product and the sale of Third-Party Products (TPPs), it has been observed during TPEs that in some instances, TPPs are being bundled with the primary credit product and. this practice goes against regulatory guidance. TPPs should be offered with a minimum gap of one month and strictly based on the customer's need and choice, and not as a mandatory requirement.

ACTION REQUIRED

REs offering TPPs must adhere to industry standards and ensure that such products are offered only after a minimum gap of one month from the disbursement of the primary credit product.



Members are advised to ensure that all the above standards are duly and consistently implemented across their internal processes and systems, and that necessary controls and monitoring mechanisms are in place to ensure continued compliance with the extant regulatory guidelines and applicable industry norms.



*Compendium of MFIN Directives and Advisories updated in January 2025
https://mfinindia.org/Resources/industry_standards

ANNEXURE

CLAUSES ON KEY FACT STATEMENT

Reserve Bank of India

(Commercial Banks - Responsible Business Conduct) Directions, 2025

B. Key Facts Statement (KFS) for Loans & Advances

348. The following instructions shall be applicable in cases of all retail and MSME term loan products extended by the bank. Credit card receivables are exempted from the provisions given below:

Reserve Bank of India

(Small Finance Banks – Responsible Business Conduct) Directions, 2025

B. Key Facts Statement (KFS) for Loans & Advances

348. The following instructions shall be applicable in cases of all retail and MSME term loan products extended by the bank. Credit card receivables are exempted from the provisions given below:

Reserve Bank of India

Non-Banking Financial Companies – Responsible Business Conduct) Directions, 2025

A. Key Facts Statement (KFS) for Loans & Advances

29. The following instructions shall be applicable in cases of all retail and MSME term loan products extended by all NBFCs. Credit card receivables are exempted from the provisions given below:

(1) The RE shall provide a KFS to all prospective borrowers to help them take an informed view before executing the loan contract, as per the standardised format given in the Annex. The KFS shall be written in a language understood by such borrowers. Contents of KFS shall be explained to the borrower and an acknowledgement shall be obtained that they have understood the same.

(2) The KFS shall be provided with a unique proposal number and shall have a validity period of at least three working days for loans having tenor of seven days or more, and a validity period of one working day for loans having tenor of less than seven days. Validity period refers to the period available to the borrower, after being provided the KFS by the RE, to agree to the terms of the loan. The RE shall be bound by the terms of the loan indicated in the KFS, if agreed to by the borrower during the validity period.

(3) The KFS shall also include a computation sheet of annual percentage rate (APR), and the amortisation schedule of the loan over the loan tenor. APR will include all charges which are levied by the bank.

(4) Charges recovered from the borrowers by the RE on behalf of third-party service providers on actual basis, such as insurance charges, legal charges etc., shall also form part of the APR and shall be disclosed separately. In all cases wherever the RE is involved in recovering such charges, the receipts and related documents shall be provided to the borrower for each payment, within a reasonable time.

(5) Any fees, charges, etc. which are not mentioned in the KFS, cannot be charged by the RE to the borrower at any stage during the term of the loan, without explicit consent of the borrower.

(6) The KFS shall also be included as a summary box to be exhibited as part of the loan agreement.



For any suggestion/clarification/query,
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